REPORT ON EXAMINATION

OF THE

STATE VOLUNTEER MUTUAL INSURANCE COMPANY

NASHVILLE, TENNESSEE

AS OF

DECEMBER 31, 2002

THE DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

NASHVILLE, TENNESSEE

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Nashville, Tennessee
April 21, 2004

The Honorable Alfred W. Gross
Chair, NAIC Financial Condition (E) Committee
Virginia Bureau of Insurance
320 West Washington Street, 4th Floor
Springfield, Illinois 62767-0001

The Honorable Paula A. Flowers
Commissioner of Commerce and Insurance
State of Tennessee
Nashville, Tennessee

Commissioners:

In compliance with your instructions and in accordance with Tennessee insurance laws, regulations and resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial condition examination and market conduct review was made of the condition and affairs of the

State Volunteer Mutual Insurance Company
Brentwood, Tennessee

hereinafter referred to as the "Company," at its home and executive offices located at 101 Westpark Drive, Brentwood, Tennessee 37027, and the following Report on Examination is submitted:

SCOPE OF EXAMINATION

This examination, covering the period from January 1, 1998 to December 31, 2002, including any material transactions and/or events noted occurring subsequent to December 31, 2002, was conducted by examiners of "The Department of Commerce and Insurance", State of Tennessee.

Our examination was conducted in accordance with examination policies and standards established by "The Tennessee Department of Commerce and Insurance", Insurance Division and procedures recommended by the National Association of Insurance Commissioners (NAIC) and, accordingly, included tests of such accounting records and such other examination procedures, as we considered necessary in the circumstances.

Our examination included a review of the Company's business policies and practices, management and corporate matters, verification and evaluation of assets and a determination of the existence of liabilities. In addition, our examination included tests to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly.

An independent public accounting firm audits the Company annually. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 1998 through 2002. We placed substantial reliance on the audited financial statements for calendar years 1998 through 2001, and consequently, performed only minimal testing for those periods. We reviewed the workpapers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2002, and directed our efforts to the extent practical to those areas not covered by the firm's audit.

STATUS OF PRIOR EXAMINATION FINDINGS

The exception conditions and recommendations made in our preceding Report on Examination dated December 18, 1998, which covered the period from January 1, 1993 through December 31, 1997 were as follows:

1. Losses

Recommendations resulting from the examination by the consulting actuaries are as follows:

- We recommend that, given the significant differences between loss and LAE reserves that a portion of loss reserves be reallocated to LAE reserves. Specifically, we recommend that $25 million be reallocated from net loss reserves to net LAE reserves.
- We recommend that the actuary reasonable allocate loss and allocated loss adjustment expense (ALAE) reserves in future reserve studies.
- We recommend that the Company allocate a reasonable portion of total bulk and incurred-but-not-reported (IBNR) reserves to ALAE in future annual statements.
- We recommend that the Company clarify whether booked reserves are net or gross of anticipated salvage and subrogation. If booked reserves are gross, the Company should recognize that reserves estimated by the consulting actuary, and with which booked reserves are compared, are calculated on a net basis. If booked reserves are net, the amount of anticipated recoveries should be displayed in Schedule P.
- We recommend that the Company book reserves for additional reinsurance premiums payable that are consistent with booked ceded loss and ALAE reserves for the retrospective rated reinsurance layer.
- Due to the particularly wide range of potential reserve estimates for the DD&R benefit, we recommend that this reserve be continually monitored.

For the current period under review, the Company complied with the recommendation and reallocated the reserves between loss and loss adjustment expenses at December 31, 1998.

2. Taxes, licenses and fees (excluding federal income taxes)

Included by the Company under this caption were accounts for items unrelated to taxes, licenses and fees. These accounts were for accrued vacation payable and the Company self-insured employee benefits accounting. It is recommended that the Company include these accounts under the proper account classification in its statutory statement filings.

For the current period under review, the Company correctly classified these expenses.

3. Federal income taxes (excluding deferred taxes)

The Company is a party to consolidated federal tax filing together with State Volunteer Real Estate, Inc., and which in the past also included MFV, Inc. and Sy.Med of Tennessee, LLC. There has never been an agreement between the parties pertaining to the settlement of balances in connection with the consolidated tax filing. The Company appears to account solely for the aggregate tax payable. It is recommended that the parties to the consolidated filing enter into an agreement and settle balances due to or from on a regular basis.

For the current period under review, the Company has not complied with this recommendation. Further comments are included in this report under the caption "Comments and Recommendations".

4. Prior Examination Recommendations

With reference to the commentary contained elsewhere in this report of examination under the caption titled "Compliance with Prior Examination Recommendations" the following recommendations are re-stated and included with this Report:

a. Internal Audit Tests or Reviews
b. Review and Approval of System Changes
c. Rehearsals for the Company's Disaster Plan

a) For the current period under review, the Company has complied with the recommendation. The Company's external auditors annually perform extended audit function in the areas of Information Systems, Underwriting and Premiums, Claims and Investments.
b) According to management, management reviews and participates in the testing process of all major changes and projects. Staff has the authority to implement minor changes to certain applications/processes that will facilitate uninterrupted operation of the Company. All such changes are reported to management.
c) According to management, since 1999, the Company has contracted with Sungard Availability Services for the recovery provisions for all computer systems, applications, programs and data. The examiners reviewed the Company's Business Continuity Plan. Testing of the recovery plan was done in November 2003.

5. Internal Security Standards

It is recommended that the Company should take steps to change the date fields in the various databases to eight (8) digits so that years are entered using all four digits.

For the examination, the Company was in the process of installing an in-house developed client-server system, and management estimates this new system to be operational and in use by late 2004 or 2005.

HISTORY

General

The Company is a non-profit corporation organized under the provisions of the Tenn. Code Ann. § 56-19-101 et seq., as amended, as a mutual liability insurance company. The purposes for which the Company was organized are:

a) To engage in the business of writing contracts of insurance or reinsurance in the State of Tennessee and other states for the following kinds of insurance:

   i) Liability insurance against loss, expense or liability by reason of bodily injury or death by accident, disability, sickness or disease suffered by others for which the insured may be liable or may have assumed liability. The writing of contracts of medical malpractice insurance is expressly authorized.

   ii) Disability insurance against bodily injury or death by accident and disability by sickness.

   iii) Miscellaneous insurance against loss or damage by any hazard upon any risk not provided for under Tennessee statutes relating to mutual insurance companies other than life insurance companies, not prohibited by statute of common law. The writing of medical accident insurance is expressly authorized.

b) To obtain reinsurance of risks as authorized by Tenn. Code Ann. § 56-19-120, or any successor statute thereto.

c) To undertake all other lawful activities as are not prohibited by the applicable statutes, rules, regulations or judicial interpretations of the jurisdiction(s) in which the Company shall be active.

The Company was granted a certificate of authority on April 2, 1976.

On May 15, 1976, the Company began writing professional liability and general liability policies on a modified claims made basis with limited assessable policies. As of May 1981, the Company issues non-assessable policies.

Capital /Funding

Capital contributions from potential insureds were a prerequisite to obtaining insurance from the Company. The capital contributions, ranging from $500 to $3,250, were to be assessed on the basis of the medical specialty of the applicant. The contributions were non interest bearing and were held in an escrow account until the Company was licensed to do business, at which time the monies were transferred to the paid in and contributed surplus of the Company. At December 31, 1979, the contributions were $4,444,211.

A 25% refund of the contributions was made in May 1979 and May 1980. A 50% refund of the contributions was made May 1981. Contributions, in the amount of $65,145 represent refunds owed to individual physicians who the Company has been unable to locate.

Dividends to Policyholders

The following schedule outlines the dividends paid to policyholders, for the years shown:

Year	Amount
2002	$ - 0 -
2001	$ 7,500,000
2000	$ 15,000,000
1999	$ 21,000,000
1998	$ 21,000,000

Payment of these dividends was approved by the Company's board of directors.

MANAGEMENT AND CONTROL

Board of Directors:

The bylaws state that the Board of Directors of the Company shall consist of not less than thirteen (13) directors and not more than nineteen (19) directors. The number shall consist of nine member directors, three (3) of whom shall be elected from each of the three (3) grand divisions of Tennessee, East, Middle and West; up to seven (7) additional member directors from the membership at large; the president and CEO; and up to two (2) additional non-member directors. At no time shall less than 75% of the physician membership of the Board of Directors be engaged in the full time practice of medicine. Directors are elected at each annual meeting for a term of three years and until his or her successor is elected and qualified.

A Directors term of office shall expire on the first date on which:

1. if a physician, the director ceases to be a member of the Corporation
2. if a physician, the Director's license to practice medicine in any state is revoked.
3. the completion of the current term of service during which a director attains the age of 70 or
4. the date on which the director is removed from the Board as a Director pursuant to the applicable statutes of Tennessee.

As of December 31, 2002, the following persons were serving as directors:

Name	Affiliation
Term expiring 2003:	
Hugh Francis, III, MD	Memphis Surgery & Vascular Association Memphis, TN 38119

James Gibb Johnson, MD	UT College of Medicine Memphis TN 38163
Luna, Joe L. MD	Baptist Health System Knoxville, TN 37920-1788
Raymond S. Martin, III, MD	The Surgical Clinic, PLLC Nashville, TN 37205
Gary E. Meredith, MD	Pediatric Diagnostic Associates Chattanooga, TN 37404
J. Tyler Swindle, MD	Woman's Clinic P.C. Jackson, TN 38301
Joseph L. Willoughby, MD	Private Practice Franklin, TN 37064

Term Expiring 2004

Donald H. Alexander, MPH	Tennessee Medical Association Nashville, TN 37212
John R. Crockarell, MD	Private Practice Collierville, TN 38017-8802
Lloyd G. Langston, MD	South Arkansas Ear, Nose & Throat Clinic Pine Bluff, AR 71603
Warren F. McPherson, MD, MBA	Mid State Neurosurgery, P.C. Murfreesboro, TN 37130
William A. Walker, MD	Cardiopulmonary Surgical Consultants, Inc. Johnson City, TN 37604
Steven C. Williams, MBA	President & CEO of the Company Brentwood, TN 37207

Term Expiring 2005

Jack E. Butterworth, MD	Bristol Urology Associates, P.C. Bristol, TN 37620
James T. Craig, Jr., MD, MBA	Jackson Clinic, P.A. Jackson, TN 38305
Michael A. McAdoo, MD	Milan Medical Center P.C. Milan, TN 38358
Paul C. McNabb, II, MD	Baptist Hospital Nashville, TN 37236
Elise E. Schriver, MD	Knoxville Pulmonary Group Knoxville, TN 37920

Officers:

The bylaws call for the officers of the Company to be a Chairman, a Vice Chairman, a President and CEO, one or more Vice Presidents, a Secretary, a Treasurer and such other officers as it may determine. No person may hold the office of Chairman, Vice Chairman, Secretary or Treasurer unless he or she is also a Director of the Company. The same person may be elected to fill more than one office except that one person may not simultaneously hold the offices of both President and Secretary. All officers shall hold office until their respective successors are elected and qualified, however, no person who has attained the age of sixty-five (65) may be elected to the offices of Chairman or Vice Chairman of the Board, Secretary or Treasurer.

The following persons were serving as officers as of December 31, 2002:

Warren F. McPherson, M.D., M.B.A.	Chairman of the Board
James Gibb Johnson, M.D.	Vice Chairman of the Board
Steven C. Williams, M.B.A.	President and CEO
Paul C. McNabb, II, M.D.	Secretary and Vice Chairman-Elect
James T. Craig, Jr., M.D., M.B.A.	Treasurer
Robert P. Boren, CPA	Executive Vice President & CFO
Jack E. Butterworth, Jr., M.D.	Vice President
Raymond S. Martin, III, M.D.	Vice President
J. Tyler Swindle, M.D.	Vice President
James W. Howell, J.D.	Vice President- Claims
James E. Smith, CPCU	Vice President – Underwriting
Raymond M. Meador, Jr., M.B.A.	Vice President - Marketing
Jackie F. Hough, R.N., BSN	Vice President – Risk Management
Thomas H. Stearns, FACMPE	Vice President – Medical Practice Services
Robert E. Byrd	Vice President – Special Projects
Susan L. Swatzell	Controller & Assistant Corporate Secretary
D. Mart Sesler	Assistant Vice President – Info. Systems
Beverly D. Gibson	Assistant Vice President – Info. Systems
Donna W. Berg, R.N., LNC	Assistant VP – Medical Information Serv.
David Dowland, ARM	Assistant Vice President – Underwriting
Charmy M. Shrode, CIC	Assistant Vice President – Underwriting
Robert A. Zika, J.D.	Assistant Vice President – Claims
C. Alan Lancaster, J.D.	Assistant Vice President – Claims
Logan G. Fulks, Jr., J.D.	Assistant Vice President – Claims
JoAnn C. Cutting, J.D.	Assistant Vice President – Claims, Memphis
Rochelle E. Weatherly, J.D.	Assistant Vice President – Marketing
Susan Decareaux, CISR, RLU	Assistant Vice President – Marketing
Deborah B. Willis, J.D.	Assistant VP – Risk Management

Committees:

As of December 31, 2002, the Company's board of directors had established the following committees:

Executive Committee:
James Gibb Johnson, M.D. - Chairman
Jack E. Butterworth, Jr., M.D.
James T. Craig, Jr., M.D., M.B.A.
John R. Crockarell, M.D.
Paul C. McNabb, II, M.D.

Claims Management Committee:
John R. Crockarell, M.D. - Chairman
Paul C. McNabb, II, M.D.
R. Benton Adkins, Jr., M.D.
Jack E. Butterworth, Jr., M.D.
James Gibb Johnson, M.D.

Raymond S. Martin, III, M.D.
Warren F. McPherson, M.D., M.B.A.
J. Tyler Swindle, M.D.
Steven C. Williams, M.B.A.

Joe L. Luna, M.D.
Raymond S. Martin, III, M.D.
Warren F. McPherson, M.D., M.B.A.
Gary E. Meredith, M.D.
Elise E. Schriver, M.D.
J. Tyler Swindle, M.D.
William A. Walker, M.D.

Underwriting Committee:
James T. Craig, Jr., M.D., M.B.A.-Chairman
Robert E. Bowers, M.D.
Burgin E. Dossett, Jr., M.D.
Hugh Francis, III, M.D.
James T. Galyon, M.D.
James Gibb Johnson, M.D.
Christine Kasser, M.D.
Lloyd G. Langston, M.D.
Paul C. McNabb, II, M.D.
Warren F. McPherson, M.D., M.B.A.
Thomas Meriwether, III, M.D.
Howard L. Salyer, M.D.
Julia Thompson, M.D.
Joseph L. Willoughby, M.D.
Terry J. Witt, M.D.

Investment Committee:
James T. Craig, Jr., M.D., M.B.A.-Chairman
John R. Crockarell, M.D.
Hugh Francis, III, M.D.
James Gibb Johnson, M.D.
Joe L. Luna, M.D.
Raymond S. Martin, III, M.D
Paul C. McNabb, II, M.D.
Warren F. McPherson, M.D., M.B.A.
William A. Walker, M.D.

Risk Management Committee:
Jack E. Butterworth, Jr., M.D. – Chairman
J. Kelley Avery, M.D.
John R. Crockarell, M.D.
Burgin E. Dossett, Jr., M.D.
Daniel S. Ely, M.D.
James Gibb Johnson, M.D.
Eugene C. Mangiante, Jr., M.D.
Paul C. McNabb, II, M.D.
Warren F. McPherson, M.D., M.B.A.
Douglas O. Olsen, M.D.
Walter Puckett, III, M.D.
Jackie F. Hough, R.N., BSN

Legislative Liaison Committee:
Joseph L. Willoughby, M.D.-Chairman
Donald H. Alexander, M.P.H.
J. Kelley Avery, M.D.
Jack E. Butterworth, Jr., M.D.
Nat E. Hyder, Jr., M.D.
James Gibb Johnson, M.D.
Timothy F. Linder, M.D.
Paul C. McNabb, II, M.D.
Warren F. McPherson, M.D., M.B.A.
Charles W. White, M.D.

Arkansas Advisory Committee:
Lloyd G. Langston, M.D.- Chairman
John G. Elders, M.D.
F. Scott Ferguson, M.D.
Wayne A. Hudec, M.D.
Randal F. Hundley, M.D.

Compensation Committee:
James T. Galyon, M.D. - Chairman
Jack E. Butterworth, Jr., M.D.
James Gibb Johnson, M.D.
Joe L. Luna, M.D.
Paul C. McNabb, II, M.D.

John O. Lytel, M.D.
Brenda N. Powell, M.D.
Jane Sneed, M.D.
W. Everett Tucker, M.D. (Resigned May 8, 2003)
Dennis B. Yelvington, M.D.
Warren F. McPherson, M.D., M.B.A.
J. Tyler Swindle, M.D.
Joseph L. Willoughby, M.D.

Budget Committee:
Joseph L. Willoughby, M.D.- Chairman
James T. Craig, Jr., M.D., M.B.A.
James T. Galyon, M.D.
James Gibb Johnson, M.D.
Joe L. Luna, M.D.
Paul C. McNabb, II, M.D.
Warren F. McPherson, M.D., M.B.A.

Audit Committee:
Robert A. Kerlan, M.D. - Chairman
David G. Gerkin, M.D.
Robert H. Haralson, M.D.
Donald Voth, CPA

Conflict of Interests

The Tenn. Code Ann. § 48-18-301 requires insurers to have a board of directors' resolution or by-law setting forth the Company's policy regarding the disclosure of possible conflicts of interests on the part of its directors or officers. Our examination disclosed that the Company did have such a policy in its bylaws. Our review of the conflict of interest questionnaires for the years under examination disclosed no reported conflicts. Furthermore, our examination did not disclose any conflicts of interest that would adversely affect the Company.

Pecuniary Interest and Commission Equity

During the examination, a review was made compliance with Tenn. Code Ann.§ 56-3-103, which states that officers must not be pecuniarily interested in investment or disposition of funds of the Company. The Company appears to be in compliance with Tenn. Code Ann.§ 56-3-103.

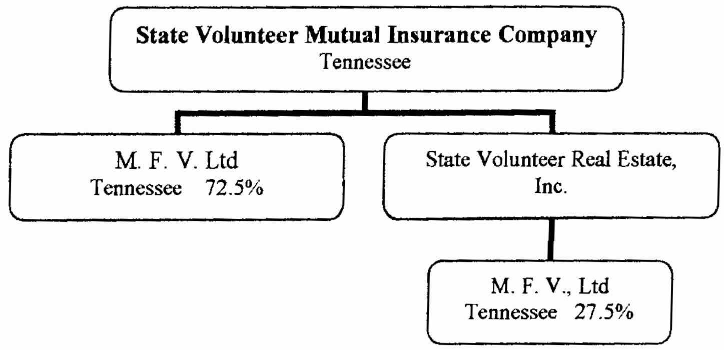
Corporate Records

We reviewed the minutes of the meetings of the board of directors, the executive committee and various other committees for the period under examination. The minutes appear to properly reflect the acts of those respective bodies.

On January 19, 1999, the board of directors reviewed "The Tennessee Department of Commerce and Insurance's" Report on Examination as of December 31, 1997.

AFFILIATED COMPANIES

The holding company structure as of December 31, 2002, is depicted in the following chart. Also shown is the state of incorporation and percent of holding:



FIDELITY BOND AND OTHER INSURANCE

The Company is insured on a fidelity bond, issued to the Company, which provides coverage in the amount of $5,000,000 for a single loss and in the aggregate during the bond period. The coverage exceeds the minimum amount of fidelity bond coverage recommended by the NAIC for the Company. The company, Fidelity and Deposit Company of Maryland is licensed in the state of Tennessee.

In addition, the Company had other insurable risks (e.g., liability, business property). Based on our review, the Company's insurance coverage for these risks appeared to be adequate.

PENSION AND INSURANCE PLANS

Employee Pension Plan:

The Company maintains a non-contributory defined benefit retirement plan covering substantially all employees.

The actuarial present value of the accumulated benefit obligation, as determined by the Company's consulting actuary, as of December 31, 2002, totaled $5,521,076, including vested benefits of $5,187,101. The aggregate fair value of investments and other assets available for plan benefits as of December 31, 2002, totaled $4,550,646.

Thrift Plan:

The Company has a defined contribution thrift plan available to all employees. Participation in the plan is entirely voluntary at the option of the employee. Under this qualified defined contribution plan, participants could contribute up to 15 percent of their monthly compensation. The Company makes matching contributions equal to 100 percent of the employee contribution up to a maximum of 6% of the employee's salary. Company contributions for 2002 under this plan totaled $425,000.

Postretirement Benefit Plan:

The Company provided no postretirement medical and dental coverage to its retirees.

Other Insurance and Benefits:

The Company provides medical and dental coverage, with the Company paying most of the cost. It also provides life insurance and disability benefits that are fully or partially funded by the Company or made available as optional coverage.

In addition, the Company has available a medical reimbursement account, a medical deductible reimbursement account and long term care insurance.

STATUTORY DEPOSITS

In compliance with Tenn. Code Ann.§ 56-2-104(e), the Company maintained a deposit for the benefit of all policyholders.

In addition, the Company maintained statutory deposits with the states of Georgia and North Carolina and the Commonwealth of Virginia. These deposits were held for the protection of the policyholders of those jurisdictions.

As of December 31, 2002, the statutory deposits were:

Jurisdiction and Description	Par or Book Value	Statement Value	Market Value
Tennessee:			
U.S. Treasury Note, 6.25% Due February 15, 2003	$100,000	$100,057	$100,594
Federal Home Loan Bank Global Senior Note, 5.8% Due September 2, 2008	$1,300,000	$1,336,671	$1,463,722
Georgia:			
U.S Treasury Note, 5.875% Due November 15, 2005	$35,000	$35,326	$38,817
North Carolina:			
U.S. Treasury Note, 6.25% Due February 15, 2003	$55,000	$0	$55,327
Virginia:			
U.S. Treasury Note, 6.25% Due February 15, 2003	$250,000	$250,142	$251,485
Totals	**$1,740,000**	**$1,722,196**	**$1,909,945**

Pursuant to a determination by "The Tennessee Department of Commerce and Insurance"

Analyst, the Company was directed to reflect the North Carolina statutory deposit as a non-admitted asset, pursuant to the guidance of Tenn. Code Ann. § 56-1-405.

The above deposits were verified by direct correspondence with the custodian of the deposit.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2002, the Company was authorized to transact business in Tennessee and nine other jurisdictions. The Company offers professional liability, on a modified claims made basis, to individual physicians, as well as group practices, and professional liability to health care facilities and providers. As of December 31, 2002, the policyholder count was 15,112 individual physicians and 1,355 groups. Direct written premiums, by jurisdiction, as of December 31, 2002 is as follows:

States	Direct Premiums Written	Direct Premiums Earned	Dividends Paid or Credited to Policyholders on Direct Business	Direct Losses Paid (Deducting Salvage)	Direct Losses Incurred	Direct Losses Unpaid
Alabama	$1,621,323	$1,357,548	$70,809	$0	$584,735	$2,077,727
Arkansas	21,563,853	15,964,017	372,581	1,973,500	16,384,902	24,366,727
Georgia	1,922,197	1,685,447	94,106	1,517,000	3,399,954	4,401,210
Kentucky	10,709,308	8,460,328	156,397	1,815,000	6,628,193	9,202,301
Mississippi	1,578,715	1,362,956	46,993	0	1,963,784	3,472,528
Tennessee	119,229,744	112,131,111	6,844,478	58,181,794	83,395,464	298,511,847
Virginia	7,388,179	5,679,322	72,115	618,535	4,500,803	6,088,156
Totals	**$164,013,319**	**$146,640,729**	**$7,657,479**	**$64,105,829**	**$116,857,835**	**$348,120,496**

Plan of Operation

The Company's business is primarily written on a direct basis, however, in Virginia and Arkansas, the business is written on both a direct and agency basis. During the year 2002, business was transacted in all licensed jurisdictions except Indiana, Missouri and North Carolina. Of the total direct premiums written, 93% was written in the states of Tennessee (73%), Arkansas (13%) and Kentucky (7%).

GROWTH OF COMPANY

The following exhibit depicts certain aspects of the growth and financial history of the Company for the years shown:

Year	Gross Premiums Written	Net Premiums Written	Premiums Earned	Losses & LAE Incurred	Net Income	Admitted Assets	Policyholder Surplus
*1997	$86,150,342	$67,330,563	$65,629,426	$59,352,062	$9,424,302	$488,136,472	$119,141,015
1998	83,955,008	67,573,948	69,018,629	65,684,363	7,690,458	518,242,531	129,417,869
1999	88,741,815	73,653,596	72,047,345	69,800,623	6,262,743	546,723,288	143,649,267
2000	98,036,367	77,369,006	73,120,430	80,737,493	4,304,911	536,593,113	138,162,291
2001	120,375,244	94,533,687	83,274,169	91,751,523	2,988,786	561,206,738	137,176,287
*2002	164,013,319	130,778,230	112,905,640	131,280,318	(2,243,357)	598,022,606	129,287,212

* Examination Report

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

The Company files its forms and rates with "The Tennessee Department of Commerce and Insurance". The Company had a number of rate revisions during the period under examination.

The policy offered by the Company is a modified claims-made professional liability policy for physicians and surgeons. Coverage is provided for claims asserted while the policy is in effect for occurrences during the period of continuous coverage with the Company. The modification offered by the Company automatically extends coverage for claims arising after the retirement, death or permanent disability of the insured. In the event of termination other than death, disability or retirement, the policyholder has the right, upon payment of a premium, to purchase tail coverage.

In addition, the Company offers premises liability, professional liability tail, employee professional liability and an office package.

A review was made of the form filings with "The Tennessee Department of Commerce and Insurance". Form BLK EX 11/93 was approved by "The Tennessee Department of Commerce and Insurance" on February 18, 1994.

Rate revisions were filed in June 1999, for tail coverage; June 2000 for a 9.5% increase; June 2001 for a 17.3% increase; June 2002 for a 15.1% increase and June 2003 for a 16.3% increase.

The Company's risk retention limits are $1.0 million.

It appears the Company is in compliance with the Tennessee statutes pertaining to rates and forms.

Advertising and Sales Material

The Company advertises its products to persons in the medical provider community. The advertising focuses on the Company's products and services. The Company maintained an advertising file for the period under examination. The file was reviewed and no exception was noted as to content and material.

Treatment of Policyholders

Our review of the Company's claims and incidents settlement practices disclosed that the Company's claims settlements were resolved properly and timely and in accordance with the requirements of Tenn. Code Ann.§ 56-8-104.

Privacy of Consumer Information

Tenn. Comp. R. & Regs. Tit. Dep't of Commerce and Ins., ch. 0780-1-72 addresses Privacy and Consumer Information and governs the treatment of nonpublic personal information about individuals by all licensees of "The Insurance Division" of "The Department of Commerce and Insurance". Under these rules the licensee is to provide notice to individuals about its privacy policies and practices; describe the conditions under which nonpublic personal information about individuals may be disclosed to affiliates, non affiliated third parties; and provide methods for individuals to prevent a licensee from disclosing nonpublic personal information.

Subsection .02 further states that these rules do not apply to information about companies or about individuals who obtain products and services for business, commercial or agricultural purposes.

It is the Company's position that it is exempted from this rule as it primarily provides its products and services for business purposes only, that is, it exclusively provides medical professional liability for physicians and surgeons and their practice entities.

Complaints

The Company's records of filed complaints were reviewed and found to be in compliance with the established procedures. During the period under examination, a total of eleven complaints were recorded. One complaint was filed with the Policyholder's Service Section of the Tennessee Insurance Department.

LOSS EXPERIENCE

The following details the Company's loss experience, for the years under review, as reported in its annual statements filed with "The Tennessee Department of Commerce and Insurance":

	Losses	LAE	Premiums	Loss
Year	**Incurred**	**Incurred**	**Earned**	**Ratio**
1997	$46,419,410	$12,932,652	$65,629,426	90.44%
1998	17,896,239	47,788,124	69,018,629	95.17%
1999	46,219,545	23,581,078	72,047,345	96.88%
2000	55,511,373	25,226,120	73,120,430	110.42%
2001	57,931,625	33,819,898	83,274,169	110.18%
2002	81,602,962	49,677,356	112,905,640	116.27%

REINSURANCE

ASSUMED BUSINESS:

The Company does not assume any business.

CEDED CONTRACTS:

1. Type: Primary Excess of Loss Reinsurance Contract
   Reinsurer: Various Underwriters at Lloyds 42.5%
   Hannover Re 17.5%
   Converium Limited 10.0%
   Transatlantic Reinsurance Company 22.50%
   Odyssey Re America 7.50%
   Term: Effective September 1, 2001 thru August 31, 2004
   Termination: August 31, 2002 or subsequent anniversary date by either party giving 90 days prior written notice
   Ceded: Medical Practitioners' liability; non owned auto liability; personal umbrella; managed care organization liability covering professional injury liability and business errors and omissions liability; hospital professional liability and associated commercial general liability.
   Cover: A) 100% of the excess of $1.0 million of the ultimate net loss of each and every loss each policy subject to a maximum of $4.0 million ultimate net loss each and every loss, each policy and/or section and/or insured; and/or subject to:
   B) 100% of the excess of $1.0 million ultimate net loss each every occurrence, subject to a maximum of $4.0 million ultimate net loss each and every loss occurrence.

2. Type: First Excess Cession Reinsurance
   Reinsurer: Various Underwriters at Lloyds 42.5%
   Hannover Re 17.5%
   Converium Limited 10.0%
   Transatlantic Reinsurance Company 22.50%
   Odyssey Re America 7.50%

Term: Effective September 1, 2001 through August 31, 2004

Termination: On any subsequent September 1 by either party giving 90 days prior written notice

Ceded: Medical Practitioners' liability; non owned auto liability; personal umbrella; managed care organization liability covering professional injury liability and business errors and omissions liability; hospital professional liability and associated commercial general liability.

Cover: A) Medical Practionners' Liability and Hospital Professional Liability:

1. 100% of the excess of $2.0 million up to a maximum of $11.0 million of the net loss of each and every loss each original policy and/or insured and 100% of the excess of $4.0 million up to a maximum of $13.0 million in the aggregate each original policy and/or insured.

B) Personal Umbrella other than those included in A) above and Hospital Commercial General Liability and Professional Premises Liability:

2. 100% of the excess of $2.0 million up to a maximum of $11.0 million of the net loss of each and every loss each original policy and/or insured and 100% of the excess of $2.0 million up to a maximum of $11.0 million in the aggregate each original policy and/or insured.

C) Managed Care Organization Professional Injury:

3. 100% of the excess of $2.0 million up to a maximum of $11.0 million of the net loss of each and every loss each original policy and/or insured and 100% of the excess of $4.0 million up to a maximum of $13.0 million in the aggregate each original policy and/or insured, and

Managed Care Organization Business Errors and Omissions Liability: 100% of the excess of $2.0 million up to a maximum of $11.0 million of the net loss of each and every loss each original policy and/or insured and 100% of the excess of $4.0 million up to a maximum of $13.0 million in the aggregate each original policy and/or insured.

3. Type: Catastrophe Awards Made Excess of Loss Reinsurance

Reinsurer: Various Underwriters at Lloyds 96.5%
Converium Limited 3.5%

Term: Effective September 1, 1993

Termination: By either party any September 1 upon 90 days prior written notice.

Coverage: Indemnification as regards liabilities incurred as a result of awards in excess of policy limits. Reinsurer pays up to a maximum $20.0 million in excess of $500,000.

All reinsurers were authorized in accordance with Tenn. Code Ann.§ 56-2-208, except for the following:

a) E&S Rueck for which a letter of credit in the amount of $ 374,687 is held;
b) Odyssey Re (UK) for which a letter of credit in the amount of $ 174,894 is held; and
c) Zurich Specialties London Limited for which a letter of credit in the amount of $ 973,582 is held.

All of the Company's reinsurance agreements were reviewed and found to contain the standard provision for arbitration, cancellation, errors and omissions, exclusions, insolvency, offset, settlement, taxes and termination.

ACCOUNTS AND RECORDS

The Company's books and records are located and maintained at 101 Westpark Drive, Suite 300, Brentwood, Tennessee 37027. A satellite claims office is located at 6800 Poplar Avenue, Suite 110, Memphis, Tennessee 38138. Archived records are located at an offsite location in Nashville, Tennessee. It appears the Company is in compliance with Tenn. Code Ann. § 56-2-104(a)(5).

The Company's general accounting records consisted of an automated general ledger and various subsidiary ledgers (e.g., cash receipts, cash disbursements). Our review did not disclose any significant deficiencies in these records.

The Company's Risk Based Capital was reviewed for compliance with NAIC guidelines. No exceptions were noted.

FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Company as of December 31, 2002 as determined by this examination.

Balance Sheet:
- Assets
- Liabilities, Surplus and Other Funds

Statement of Income

Policyholders Surplus Account

Analysis of Examination Changes to Surplus

The accompanying Notes to Financial Statements are an integral part of these Financial Statements.

ASSETS

	Ledger Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$429,912,477	$55,031	$429,857,446
Stocks: Common stocks	27,977,141		27,977,141
Real estate: Occupied by company	600,000		600,000
Cash & short term investments	103,710,155	5,008,516	98,701,639
Other invested assets	88,035		88,035
Receivable for securities	1,134,487		1,134,487
Subtotals cash and invested assets	**558,422,295**	**5,063,547**	**553,358,748**
Premiums, agents' balances and installments booked but deferred and not yet due	33,843,846	634,412	33,209,434
Reinsurance recoverables on loss and lae payments	552,375		552,375
Federal income tax recoverable	28,248,000	23,126,000	5,122,000
Electronic data processing equipment And software	1,652,807	1,550,632	102,175
Interest, dividends and real estate income due & accrued	5,417,438		5,417,438
Other assets nonadmitted	1,410,606	1,410,606	0
Aggregate write-ins for other than invested assets	910,806	650,370	260,436
Totals	**$630,458,173**	**$32,435,567**	**$598,022,606**

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses	$ 248,376,343
Loss adjustment expenses	113,913,966
Other expenses	7,066,326
Taxes, licenses and fees	(-) 1,216,957
Federal and foreign income taxes	(-) 2,626,047
Unearned premiums	70,136,643
Advance premiums	4,603,686
Funds held by company under reinsurance treaties	28,253,100
Provision for reinsurance	217,954
Payable for securities	10,376
Total liabilities	**468,735,394**
Gross paid in and contributed surplus	65,145
Unassigned funds	129,222,067
Surplus as regards policyholders	129,287,212
Totals	**$598,022,606**

UNDERWRITING AND INVESTMENT EXHIBIT
STATEMENT OF INCOME

Underwriting Income	
Premiums earned	$ 112,905,640
Deductions:	
Losses incurred	81,602,962
Loss expenses incurred	49,677,356
Other underwriting expenses incurred	13,187,649
Total underwriting deductions	144,467,967
Net underwriting gain or (loss)	(-) 31,562,327
Investment Income	
Net investment income earned	25,531,486
Net realized capital gains or (losses)	1,610,098
Net investment gain or (loss)	27,141,584
Other Income	
Net gain or (loss) from agents' or premium balances charged off	(-) 112,180
Finance and service charges not included in premiums	0
Aggregate write-ins for miscellaneous income	329,566
Total other income	217,386
Net income before dividends to policyholders & before federal income taxes	(-) 4,203,357
Federal and foreign income taxes incurred	(-) 1,960,000
Net Income	**$ (-) 2,243,357**

RECONCILIATION OF SURPLUS FOR THE PERIOD UNDER EXAMINATION

Surplus December 31, 1998		$119,141,015
Net income, 1998	$7,690,458	
Net unrealized capital gains or (losses)	4,113,872	
Change in non admitted assets	(1,090,528)	
Aggregate write-ins for gains and losses in surplus	(436,948)	
Change in surplus as regards policyholders for the year		10,276,854
Surplus December 31, 1998		$129,417,869
Net income, 1999	$6,262,743	
Net unrealized capital gains or (losses)	8,050,099	
Change in non admitted assets	(81,444)	
Aggregate write-ins for gains and losses in surplus		
Change in surplus as regards policyholders for the year		14,231,398
Surplus December 31, 1999		$143,649,267
Net income, 2000	$4,304,911	
Net unrealized capital gains or (losses)	(9,655,896)	
Change in non admitted assets	(135,991)	
Aggregate write-ins for gains and losses in surplus		
Change in surplus as regards policyholders for the year		(5,486,976)
Surplus December 31, 2000		$138,162,291
Net income, 2001	$2,988,786	
Net unrealized capital gains or (losses)	(5,475,882)	
Change in net deferred income tax	724,000	
Change in non admitted assets	(4,590,418)	
Cumulative effect of changes in accounting principles	5,367,510	
Change in surplus as regards policyholders for the year		(986,004)
Surplus December 31, 2001		$137,176,287
Net income, 2002	$(-) 2,243,357	
Net unrealized capital gains or (losses)	(3,367,201)	
Change in net deferred income tax	1,633,000	
Change in non admitted assets	(8,702,079)	
Change in provision for reinsurance	(217,954)	
Aggregate write-ins for gains and losses in surplus	5,008,516	
Change in surplus as regards policyholders for the year		(7,889,075)
Surplus December 31, 2002		$129,287,212

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION

Cash: $(-)1,807,845

The above amount is $5,008,516 less than the amount reported by the Company in its 2002 Annual Statement. During our review we noted that the Company reported outstanding checks as a liability in lieu of decreasing cash. This is contrary to the requirements of SSAP #2. Further comments will be found in this Report under the section Recommendations.

Other Expenses: $7,066,326

The above amount is $5,008,516 less than the amount reported by the Company in its 2002 Annual Statement. The Company reported outstanding checks as a liability in lieu of decreasing cash. For the purposes of this Report the examiners have reclassified this liability to its proper caption, Cash. Further comments will be found in this Report under the section Recommendations.

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AS THEY AFFECT SURPLUS

Item	Reclassification	Increase	Decrease	Surplus
Surplus as regards policyholders December 31, 2002:				**$129,287,212**
Cash	(-) 5,008,516		5,008,516	
Other Expenses	(-) 5,008,516	5,008,516		
Totals	$0	$5,008,516	$5,008,516	
Total increase/decrease per Examination				0
Surplus as regards policyholders per Examination				**$129,287,212**

COMMENTS AND RECOMMENDATIONS

Comments

Federal income taxes (excluding deferred taxes)

In the prior Report on Examination, it was recommended that the Company enter into an agreement between its affiliated entities pertaining to the settlement of balances in connection with consolidated tax filing and settle balances on a regular basis.

For the current period under review, the Company has not complied with this recommendation. According to management, the Company requested guidance from its corporate tax advisors on the necessity for such an agreement. The advisor determined that, in accordance with the Internal Revenue Code, a tax sharing agreement exists by law and that no explicit need exists for the Company to have a separate, written tax sharing agreement outside of the one given to it by default under the Internal Revenue Code. Due to the advisor's determination and the limited scope of the Company's wholly owned subsidiary's current non-insurance operations, management determined not to execute an agreement at the present time.

Custody Agreement

During the review of the Company's invested assets, it was noted that the custodian agreement in effect as of the date of this examination was not in compliance with the requirements of Tennessee statutes and regulations governing the placement of insurance company securities. Tenn. Comp. R. & Regs. Tit. Dep't of Commerce and Ins. ch. 0780-1-46-.04 requires the following:

> (1)(a) Insurance companies shall have executed the appropriate Custodian Affidavits Forms A, B or C for its securities held under a custodial agreements. Such executed forms shall be available for purposes of insurance company examinations under Tenn. Code Ann.§ 56-1-408 through § 56-1-413. Failure to provide the appropriate custodian affidavit will result in the Insurance Department treating as non-admitted assets those of an insurance company's securities held by the custodian; further, for the purposes of such examinations, the underlying agreement between an insurance company and a custodian shall be available. An insurance company shall require - in addition to any other provision - that such custodial agreement provide a standard of responsibility on the part of the custodian which shall not be less than the responsibility of a bailee for hire or a fiduciary under statutory or case law of Tennessee; that securities held by the custodian are subject to instructions of the insurance company; and that securities may be withdrawn immediately upon demand of the insurance company.

The Company's custodian agreement did not contain the specific language requiring that the custodian provide a standard of responsibility which shall not be less than the responsibility of a bailee for hire or a fiduciary under statutory or case law of Tennessee. During our examination, after we brought this condition to the Company's attention, the Company took the necessary action and had the custody agreement amended to include the required language. The amendment was executed on August 4, 2003.

Reinsurance

During the review of the Company's reinsurance program, we noted that Tenn. Code Ann. § 56-19-120 states that mutual companies "may reinsure any part or all of any risk or risks, in any insurance company or insurer **licensed** in this state;" Tenn. Code Ann. § 56-19-122 states that insurance companies organized or admitted under this chapter "are not subject to any other law of this state governing insurance companies unless they are specifically mentioned or clearly included in its terms".
Tenn. Code Ann. § 56-2-208 permits domestic insurers to take credit for reinsurance cessions "as either an asset or a reduction from liability..." There is no cross-reference from Tenn. Code Ann. § 56-19-120 to Tenn. Code Ann. § 56-2-208, or vice-versa. It is the position of the Department that the Company may reinsure with entities that meet the standards set forth in Tenn. Code Ann. § 56-2-208, and that such is not a violation of Tenn. Code Ann. § 56-19-120.

Funds Held by Company Under Reinsurance Treaties

The liability, Funds Held by Company Under Reinsurance Treaties, consists of letters of credit from unauthorized reinsurers, in the amount of $4,123,308 and $24,129,792 for estimated additional ceded premiums payable based on the Company's cumulative incurred loss and loss adjustment expenses. This amount is calculated and payable one year after the expiration of the contract year.

In the year 1999 and prior, the company reported this liability under the caption, Aggregate Write Ins for Liabilities. For the year 2000, pursuant to a directive from the Tennessee Department of Commerce and Insurance, Insurance Division Analysis Section, the Company reported the estimated additional retrospective premiums under this liability, Funds Held by Company Under Reinsurance Treaties.

According to the annual statement instructions, SSAP #66, IP 66 and IP 75, the liability should be reported as Aggregate Write Ins for Liabilities.

Because of "The Tennessee Department of Commerce and Insurance" directive, the examiners made no adjustments or reclassifications.

Cash and Other Expenses

For the period under review, the Company reported outstanding checks under the liability, Other Expenses, in lieu of decreasing cash. This is contrary to the requirements of SSAP #2, Cash, Drafts, and Short Term Investments, which provides guidance on the reporting or treatment of negative cash balances. The Company was advised to report outstanding checks in accordance with the requirements of SSAP #2.

During our examination, after we brought this condition to the Company's attention, the Company took the necessary action and in its 2003 annual statement reported outstanding checks in accordance with SSAP #2.

Recommendations

Accounts and Records – Fraud Plan

Tenn. Code Ann. § 56-53-101 et seq. required, by January 1, 2002, that every insurer, including any "entity which falls within the definition of insurer found within title 56", with direct written premiums exceeding ten million dollars, to prepare, implement, and maintain an insurance anti-fraud plan. Tenn. Code Ann. § 56-53-111 (a)(2), in part, provides for the anti-fraud plan to be reviewed at the time of the insurance company's financial examination or market conduct examination. The examiners were informed that the Company does not currently have a formal fraud plan as it appears to be exempted from the requirements based on Tenn. Code Ann. § 56-53-111(b). According to the Company, Tenn. Code Ann. § 56-53-111(b) applies to a two party insurance policy and claims, whereby it is the policyholder who could fraudulently present a claim for which the same policyholder would be paid benefits. This does not appear to apply to third party types of coverage such as professional liability, the Company's business. The application and policy contain the following language "In the event of any fraud, material misrepresentation or omission by the insured in his/her application or renewal application for insurance, or related communications, this policy is void; no coverage is afforded hereby.." In addition, the Company writes a third party type of insurance, and has no claim form.

It appears that the Company would be exempted from the requirements of Tenn. Code Ann. § 56-53-111(a). It is recommended that the Company formally request the Tennessee Insurance Commissioner for an exemption from the requirements of Tenn. Code Ann. § 56-53-111 (a).

SUBSEQUENT EVENTS

Subsequent to December 31, 2002, on May 22, 2003, the Company issued a $15 million variable rate surplus note due 2033. The note was issued for cash to InCaps Funding I, Ltd, with Wilmington Trust Company as trustee. Payment of interest and principal may only be made from surplus and only with the prior approval of the Tennessee Insurance Commissioner. Interest in effect for the period beginning August 22, 2003 was 5.24%. The indenture agreement was submitted to and approved by the Tennessee Insurance Commissioner on April 24, 2003.

CONCLUSION

The customary insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of the liabilities of the State Volunteer Mutual Insurance Company.

Brett E. Miller, FCAS, MAAA, FCA from Agee Fisher, LLC, Atlanta, Georgia, performed the actuarial analysis and verification of the adequacy of the reserves for losses and loss adjustment expenses for the Tennessee Department of Commerce and Insurance.

As of December 31, 2002, the Company had admitted assets of $598,022,606, liabilities of $468,735,394, capital and surplus of $65,145 and unassigned funds of $ 129,222,067.

In addition to the undersigned, Rebecca E. Walker, Examiner, State of Tennessee participated in the work of this examination:

Respectfully submitted,

Ilona Klasons

Ilona Klasons, CFE, CIE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC

B. K. Shah

Bhavna Shah
Examiner
State of Tennessee
Southeastern Zone, NAIC

AFFIDAVIT

The undersigned deposes and says that she has duly executed the attached examination report on State Volunteer Mutual Insurance Company, dated April 21, 2004, and made as of December 31, 2002, on behalf of "The Tennessee Department of Commerce and Insurance". Deponent further says she is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of her knowledge, information and belief.

Ilona Klasons

Ilona Klasons, CFE, CIE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC

Subscribed and sworn to before me this

12th day of May, 2004

Helen M Dorsey

Notary

County Davidson

State Tennessee

Commission Expires 03/25/06